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SNX - SYNEX Corp to Acquire Westcon-Comstor North America and Latin America Businesses Conference Call

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PRESENTATION

Operator

Welcome to SYNEX Corporation Conference Call to discuss the definitive agreement to acquire Datatec's Westcon-Comstor Americas businesses. Today's conference is being recorded. If you have any objections, you may now disconnect. At this time, I would like to pass the call over to Mr. Mike Vaishnav, Senior Vice President, Corporate Finance and Treasurer at SYNEX Corporation. Sir, you may now begin.

Mike Vaishnav - SYNEX Corporation - SVP of Corporate Finance and Treasurer

Thank you, Jen. Good morning, and thank you all for attending this call on such short notice. Joining me for today's call are Kevin Murai, President and CEO; Dennis Polk, Chief Operating Officer; and Marshall Witt, Chief Financial Officer. The executive team will provide an overview of today's announcement followed by a Q&A session. This call is being webcast live and will be available for replay shortly after this call. The slide presentation accompanying this call is available on SYNEX's Investor Relations website at ir.synnex.com, where you can also find our press release and the call replay.

As noted in the press release and Page 2 of the slide deck, some information provided during this call may include forward-looking statements that are based on certain assumptions subject to a number of risks and uncertainties and future results may vary materially. Such statements may relate to, without limitation, features and impact of the acquisition and minority investment, future financial and operating results and our growth strategy. Actual results or trends could differ materially from our expectations.

For more information, please refer to the risk factors discussed in our Form 10-K for fiscal 2016 and subsequent SEC filings and the discussion of forward-looking statements in our press release and Form 8-K filed with the SEC today.

SYNEX assumes no obligation to update any forward-looking statements, which speak as of their respective dates. This conference call is the property of SYNEX Corporation and may not be recorded or rebroadcast without our specific written permission. And now, I will turn over the call to Kevin.

Kevin M. Murai - SYNEX Corporation - CEO, President & Director

Thank you, Mike. We're excited today to announce our definitive agreement to acquire Westcon-Comstor's North America and Latin America businesses from Datatec Limited, which comprises the U.S., Canada and Latin America markets. We are also acquiring a 10% ownership in Westcon-Comstor International, which is comprised of EMEA and APAC Westcon-Comstor regions.



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Referring to Slide 3 of the presentation, this acquisition enhances SYNEX's strong North American position, expands our footprint to Latin America and establishes a seamless platform for vendor and reseller partners that value a global offering through the Westcon-Comstor brand. This acquisition supports our strategy of shifting our business to where technology is heading.

Westcon-Comstor is a world renowned brand that has been built over the last 30 years by a deep and talented team, and we're excited to welcome the Americas group to our SYNEX family. For their fiscal year ended February 28, 2017, North America achieved approximately \$1.7 billion in revenue with approximately 600 employees and Latin America generated approximately \$500 million in revenue with over 800 employees across 12 countries.

As shown on Page 4 of the slide deck, SYNEX will gain deep capabilities and strength in the attractive security, UCC and networking markets, all of which are highly complementary to our existing portfolio. The addition of \$2.2 billion of revenue at margins that are accretive strengthens SYNEX's leadership position in North America and adds a strong presence in Latin America. The bottom of Page 4 summarizes the key technology vendors within security, UCC and networking, many of which are net-new to SYNEX.

Page 5 summarizes the total available market and attractive growth rates, which are above average IT spend. Given the highly complementary technologies, vendor relationships and markets served and geographic footprint, which is detailed on Pages 6 and 7, you can see why this deal is a win-win, not just for SYNEX and Datatec shareholders, but for all stakeholders, including our current and prospective partners and employees worldwide.

I will now ask Marshall to provide additional color regarding the transaction and key highlights. Marshall?

Marshall W. Witt - SYNEX Corporation - CFO

Thank you, Kevin, and thank you, again, everyone, for joining the call this morning. For a quick overview of the Westcon-Comstor Americas acquisition and the related financial impact, please refer to Page 8 of the deck. Pursuant to the purchase agreement, at closing, SYNEX will pay a purchase price of \$600 million, of which \$100 million will be cash and \$500 million will be SYNEX stock at an average price of \$109.67. There is a potential for Datatec Limited to earn up to an additional \$200 million in cash, which is based on certain levels of gross profit attainment for North America and Latin America. SYNEX has the option to pay out cash based on the average share price at closing. Both SYNEX and Datatec desire a stock and cash transaction. Based on seller requirements and local regulations, the number of shares will require to be established upon signing. As a way to ensure no undue burden on the purchase price, an all-cash option was created. Another important aspect of the transaction is that SYNEX will become a 10% investor in Datatec's Westcon, EMEA and APAC business for a consideration of \$30 million in cash.

For fiscal year ended February 2017, the Westcon Americas business generated approximately \$2.2 billion of revenue and approximately \$89 million of EBITDA. In the first 12 months, after close, the Westcon Americas business, excluding integration costs, transaction expenses and intangible amortization, is expected to be mildly accretive to SYNEX's EPS and then accretion is expected to accelerate in the second year. The projected cash flow generated by the combined business will be strong and allow us to further execute on our strategic goals. We plan to finance this acquisition through cash on hand and existing lines. We have a strong capital position with access to additional funds if needed. We are comfortable in our financing of this transaction and in the business moving forward. Subsequent to the closing of this transaction, our estimated debt to cap will be approximately 35% and well within our historical range, and our estimated leverage ratio on a net basis will be approximately 1.6x.

If we choose to pay all-cash, based on the option discussed earlier, converting \$500 million of equity of cash, our estimated debt to cap will be in the low 40%, and an estimated leverage ratio on a net basis will be approximately 2.4x.

As announced in today's press release, while SYNEX is going through our normal quarterly close, revenues for the second quarter ended May 31, 2017, are now estimated to come in above the high-end of our guidance range of \$3.575 billion to \$3.775 billion and non-GAAP EPS is estimated to come in above the high-end of our guidance range of \$1.70 to \$1.78. The company will report its Q2 earnings results after market closes on June 22nd. As Kevin mentioned earlier, we expect to close this acquisition during the third calendar quarter of 2017, subject to customary closing conditions and the satisfaction of domestic and foreign regulatory requirements and approvals. Now Kevin will conclude with some final thoughts before we turn it over for questions. Kevin?



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Kevin M. Murai - SYNEX Corporation - CEO, President & Director

Thank you, Marshall. At SYNEX, we are proud of our history and track record of growth and delivering shareholder value. We are leaders in our technology solutions and Concentrix segments and continue to look for opportunities to grow. Within our distribution business, we continue to shift to where technology is heading, gaining strength in the growing security, UCC and networking markets has been a priority, and we believe today's announcement is a great step forward in evolving our company.

Westcon-Comstor Americas will bring strong leadership, deep capability and knowledge and leading vendor relationships, which will enhance our leadership position. There is very little overlap between SYNEX and Westcon-Comstor, and our belief is that the combined capabilities will enable our partners to leverage the strengths of 2 great companies and position SYNEX to be even more effective in growing our vendor's and reseller's businesses. Our combined organizations are expected to produce revenues exceeding \$16.5 billion when looking at the 12 months ended February 2017. I've had the privilege of spending time with the Westcon-Comstor team and meeting with their key partners. What excites me most is how similar our 2 companies are and the strong partnerships that have been created with vendors and customers. Both organizations are extremely well aligned in vision and strategy, which will serve us well as we enhance our collective value that we will bring to the market. So as we move into Q&A, we will only be addressing questions that are related to the definitive agreement with Datatec Limited, Westcon-Comstor. I'll now open the call to Q&A where Dennis, Marshall and I will all be available to take questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will be from Mr. Matt Sheerin.

Matthew Sheerin - Stifel, Nicolaus & Company, Incorporated, Research Division - MD

Just a couple of questions from me. Just regarding the acquisition. So on the -- as you look at the accretion, you said it was mildly accretive in the first year, but accelerates in the second year. Are there synergies and cost opportunities that you're looking to take out? And if so, can you share them with us? Will there be some integration into your existing technology solutions business or is it's kind of a separate business that will run on its own?

Kevin M. Murai - SYNEX Corporation - CEO, President & Director

Matt, so as I said, this acquisition is highly complementary and that really extends across our line card as well as the customers and end markets that we serve. So, although, there's going to be some level of cross synergy in the North American business, Latin America is a net-new geography to us, and we fully expect that the bigger headline here is really the revenue synergies that we'll be able to drive given the comprehensive portfolio of products and service offerings that we'll have.

Matthew Sheerin - Stifel, Nicolaus & Company, Incorporated, Research Division - MD

Okay. Are there -- what about the reseller customer base in North America. Is there much overlap there with your existing customer base?

Kevin M. Murai - SYNEX Corporation - CEO, President & Director

There is -- obviously with the scale of our SYNEX business, there's going to be some level of overlap, but given the specialty business that Westcon-Comstor has, they sell into really the high-end of communication security and there are a number of net-new customers that we'll be bringing onboard.

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Matthew Sheerin - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay. And you told us the revenue for the last fiscal year, could you give us an idea of growth rate within that time period relative to their previous fiscal year?

Kevin M. Murai - *SYNEX Corporation - CEO, President & Director*

Yes, their -- Westcon-Comstor, as you probably know, has been going through a business transformation both in outsourcing some of their back-office and implementation of SAP in certain regions outside of North America or outside of the Americas. So their revenue has actually been flat to slight decline, but we fully expect that we'll be able to grow that business.

Matthew Sheerin - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay. And just lastly, regarding the investment in the EMEA and Asia Pacific parts of the Westcon business, what was the reasoning behind that and is that a sign that over time you may expand that position and perhaps acquire the whole company, which would obviously put you in a much different geographic position than you are with your core business?

Kevin M. Murai - *SYNEX Corporation - CEO, President & Director*

Yes, that's correct Matt. Obviously, it does give us a good pathway to look at expansion opportunities beyond just the Americas. One thing that Westcon-Comstor has, it was probably one of the first global distributors to be able to launch, was a true seamless global offering. That continues to be a robust part of their overall business. A lot of that business does get conducted in the Americas business that we're acquiring and by having a minority state in Westcon-Comstor International, that really provides us with a good foundation to continue to provide that seamless global offering to the customers and to our vendors that require that.

Operator

Our next question will be from Mr. Adam Tindle.

Adam Tyler Tindle - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Just first question for Marshall. I just wanted to understand the terms here, so the \$500 million in stock at \$109.67 would dilute shares by over 10%. Whereas, earnings dilution from interest expense would seem to be far less based on current rates and your leverage would be manageable, as you outlined. So just help us understand that trade off and why a stock deal is important to both parties?

Marshall W. Witt - *SYNEX Corporation - CFO*

Yes, Adam, I'll start and then let Kevin chime in. The -- both sides want to have a partnership and with that, as I've said in the prepared remarks, Datatec will be -- because of local regulations and their requirements, they will have to have a 10% interest in SYNEX. And so because of that, that is the desirable size to have that equity ownership. Because of the way that the deal was structured, the ultimate purchase price will be based on the closing purchase price or the closing value of the stock at the closing of the deal. So we wanted to make sure that we had appropriately limited any kind of excess burden on the purchase price and that's what introduced the cash option to that.



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Kevin M. Murai - SYNEX Corporation - CEO, President & Director

Yes, and just to reiterate the first point that Marshall made. Datatec felt that it was important for them to continue to be an investor in technology. They -- although, they're selling their Americas business to us, they continue to believe that technology is a great industry to be in and they wanted to participate in the ongoing business and value that we're able to create with the Americas business. And in addition to that, for us, with the experience that Westcon-Comstor and Datatec, for that matter, have in doing business beyond North America that we view is a great value add to our company.

Adam Tyler Tindle - Raymond James & Associates, Inc., Research Division - Research Analyst

Okay. And maybe on the integration of systems. I know SYNEX has had a home-grown ERP system, which you've mentioned as a competitive differentiator, but Westcon has just spent a couple of years undergoing an SAP implementation. Can you just talk about the plans to integrate systems here, do you go with SYNEX's or Westcon's SAP? What's the time line and the cost to do that?

Dennis Polk - SYNEX Corporation - COO and Director

Hi, Adam, this is Dennis. I'll take that one. Yes, the Americas business, at least North America has been on the SAP system for about 3 years and the Latin American business runs on a different system. It seemed to be doing quite well with the systems now, but we do have our own internal system that we've been running our business on for a couple of decades now and that is the preferred system. So we will integrate on to that platform over time. Initially, North America will be first and then followed by Latin America some time thereafter, excuse me. We were -- we are working on the integration plans right now, but it's typical as with past acquisition with SYNEX, we'll do the integration as quickly as possible and we'll work those plans in the near future.

Adam Tyler Tindle - Raymond James & Associates, Inc., Research Division - Research Analyst

Okay. Maybe just one last clarification, as Kevin mentioned that some of the operating results have been depressed at Westcon because of this transformation. The \$89 million EBITDA number, that's a trailing 12 months figure, correct? And is that -- has that been impacted by this ERP integration?

Marshall W. Witt - SYNEX Corporation - CFO

That's a trailing 12 months as of February 28, 2017, for the Americas business that we are acquiring. The Americas business, again, it's been on their systems for a bit of time now, so there has been no direct impact to that number from a systems integration standpoint. They are going through some various other efforts and transformations in their business, including a BPO outsourcing process that's affected their numbers a little bit. But for the most part, from a system standpoint, no major affect on the trailing 12 months EBITDA.

Operator

Our next question will be from Mr. Jim Suva.

Jim Suva - Citigroup Inc, Research Division - Director

In the press release and your slide in the conference call, you mentioned that you will be mildly accretive in year 1. Maybe -- I don't know, from an accounting perspective or a dictionary perspective, whatever, what do you consider mildly accretive? Was that like, I assume like single-digit percent increase accretion or below 10%, is that the way to think about it? Or how should we think about what mildly accretive means?



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Kevin M. Murai - SYNEX Corporation - CEO, President & Director

Yes, mildly accretive, and Jim understand that in the first year, we are going through a transition and integration. So mildly accretive to us would be kind of in that low- to mid-single-digit range. Really the strategic benefit of this investment goes well beyond just the transitional year, and we fully expect with growth in the business and the combined businesses as well as some synergies that we're able to drive in systems and back-office process, that we'll be able to accelerate that -- beyond that transition period, which is about the first year.

Jim Suva - Citigroup Inc, Research Division - Director

Okay. And then I see that you're also giving a -- doing a minority interest or minority ownership in some of the other regions, if you want to call it that. Well, why not just acquire all the regions or is this just kind of the early steps to see if the full-blown acquisition works? Or why not just acquire it all. I understand, geographically there is some complementary plus some new areas and some overlap, but the other products look complementary. If I -- why don't you just do an outright full acquisition of those other areas?

Kevin M. Murai - SYNEX Corporation - CEO, President & Director

Sure. And Jim, the rest of the Westcon-Comstor business is attractive for a number of reasons to us. But as they are kind of right in the middle of their transformation with SAP conversions and BPO, both companies felt it's best at this point to allow the rest of the business to focus all of their efforts on continuing to get to conclusions, successful conclusion with that transformation as well as drive their business. So from a timing perspective, we just felt that it was better for us to acquire the Americas business now and then just provide us with a pathway on looking at the international business at the right point in time.

Jim Suva - Citigroup Inc, Research Division - Director

Okay. And my last question. Does this minority interest then give you like first rights or first look in case somebody else were to look at them on the other regions or something? Or how should we think about that?

Kevin M. Murai - SYNEX Corporation - CEO, President & Director

Yes, that is correct, Jim. And since you asked the question, I'll highlight one other point too. As part of the agreement, we do have an option to acquire an additional 10% of the international business at the same price and it does provide -- and that would be for up to 1-year after we close. And then we do have certain first rights of refusal should an offer come in on all or part of the rest of the business.

Operator

(Operator Instructions) Our next question will be from Ms. Shannon Cross.

Shannon Siemsen Cross - Cross Research LLC - Co-Founder, Principal and Analyst

Can you talk a bit more about the opportunity to work together in EMEA and APJ? How you see that progressing and how the companies might further integrate, I guess, just with the 10% ownership?

Kevin M. Murai - SYNEX Corporation - CEO, President & Director

Well, as it is today, Shannon, it was important for us to have that 10% minority stake in international really for 2 reasons, but from an operational standpoint, Westcon-Comstor has a very well-regarded offering for global -- for vendors that need a global offering as well as a number of global



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customers that require the same thing. In order for us to preserve that offering and really provide a solid foundation in order to maintain ownership and interest of those that are involved in that business, having a minority interest in the rest of the business was very, very important to us.

Shannon Siemsen Cross - *Cross Research LLC - Co-Founder, Principal and Analyst*

Okay. But in terms of working together, there is no anticipation of them doing -- distributing for you or vice versa or is -- am I encrusting that?

Kevin M. Murai - *SYNEX Corporation - CEO, President & Director*

We -- as part of the agreement, there is a cooperation agreement and there is going to be cooperation, obviously, beyond just the global business that they do, do. So obviously, if there is opportunities that arise in the Americas that apply to other regions, we will help to facilitate that and vice versa.

Shannon Siemsen Cross - *Cross Research LLC - Co-Founder, Principal and Analyst*

Okay, great. And then in terms of incremental acquisitions beyond it, I mean, you've made some on Concentrix, now you're expanding on the distribution side. How are you thinking -- is this going to sort of slow you down for a while or how are you thinking about your -- the BPO side of your business in light of this acquisition?

Kevin M. Murai - *SYNEX Corporation - CEO, President & Director*

Shannon, as I've said in the past, we believe that we have 2 great businesses within the organization on the technology solutions and Concentrix side. We continue to look for opportunities in both markets that not just help us grow, but also increase our overall value-add. We've continued to see a number of opportunities within the BPO markets that we've been able to execute on. We will continue to look for those and execute on those as well. In the technology side of the business, because of the more consolidated nature of the market, there have been fewer, but we were targeted in what we were looking for on technology. As we look to where technology is shifting to, obviously, anything cloud related, anything comm and security and data related are the growth areas, which is why we're thrilled to be able to acquire the Westcon-Comstor Americas business. That distribution business really has a strong brand in the marketplace as one of the best specialty distributors in comm. So the long answer to your question, but, no, this should not slow us down. We believe we'll continue to have -- generate plenty of cash and continue to have the liquidity to acquire the right businesses as they become available for us.

Operator

At this time, speakers, we don't have any questions on queue. I'll turn the meeting back to Mr. Kevin Murai. Sir, you may now proceed.

Kevin M. Murai - *SYNEX Corporation - CEO, President & Director*

Thank you. So before we conclude the call, I want to be clear about our deep and continued focus and commitment to our partners, employees and our shareholders. We remain committed in seeking opportunities for organic and strategic growth. We remain focused in our pursuit to continually reposition SYNEX to where growth is. We are investing in resources and capabilities to ensure market share gains and margin expansion continues. I believe that our team of over 100,000 associates are the best in their respective industries because of the value they bring to all constituents, the visibility they provide and the velocity that continues to differentiate SYNEX. Thank you, again, for joining our call and we look forward to speaking to you again on June 22nd.



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Operator

Thank you. And that concludes today's conference. Thank you all for participating. You may now all disconnect, and have a great day.

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